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Restructuring the Boundaries of Parent Company Directors' Supervisory Responsibilities: Focusing on Procedural Review and the Business Judgment Rule in Compliance Failures

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Abstract. This article explores the restructuring of the supervisory responsibilities of parent company directors within multinational enterprise groups, navigating the tension between separate legal personality and the growing responsibility gap in global governance. It proposes a shift from passive diligence to a systemic operational duty, asserting that a board's oversight should focus on the adequacy of risk-reporting mechanisms rather than the personal interception of all subsidiary-level violations. The study analyzes the Delaware corporate law framework, focusing on the judicial evolution from Caremark to Marchand and McDonald's. Through this lens, it distinguishes between business decision-making and the specialized function of compliance gatekeeping. It advocates for a decentralized compliance strategy that maintains entity shielding while ensuring that mission-critical risks, including AI and data-driven algorithmic challenges, reach the board through vertical reporting fast-tracks. Ultimately, the article clarifies that the Business Judgment Rule should serve as a procedural safe harbor, where liability is only triggered by bad faith or willful blindness, thereby balancing rigorous corporate oversight with the foundational principles of limited liability.

Keywords: parent company directors, duty of oversight, business judgment rule

1. Introduction

Multinational enterprise groups have become the dominant force in the global economy; however, the principles of Separate legal personality and limited liability, strictly adhered to in corporate law, have erected a natural liability firewall between parent companies and their overseas subsidiaries. Walmart must be translated as Walmart. Major scandals such as Walmart Mexico's bribery case and Shell Nigeria's environmental pollution case frequently occur, revealing the reality of parent companies exploiting information asymmetry and governance vacuums to circumvent oversight responsibilities [1].

Under the Delaware corporate law framework, the supervisory responsibilities of the board of directors are primarily established by the Caremark case, but it focuses more on internal compliance of a single legal entity. To what extent should the parent company's board of directors be responsible for the compliance details of its subsidiaries worldwide? Is the traditional model of relying on

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periodic reporting from management sufficient to constitute fulfillment of oversight obligations [1]? When faced with systemic compliance failure, is the trigger point for the failure of the Business Judgment Rules negligence or bad faith [2]?

There are two opposing legal tendencies regarding the supervisory responsibilities of the parent company: one insists on defensive autonomy, believing that excessive supervision will undermine the independent status of the legal person and erode the foundation of limited liability; another advocates for active intervention, believing that the parent company, as the ultimate controller, should assume the obligation of systematic monitoring [3].

This article argues that the supervisory responsibility of the parent company's board of directors should not be a deep dive intervention in the subsidiary's business, but should be restructured into a systematic attention obligation centered on system operation. This study will follow the following logic: Chapter 2 reconstructs the responsibilities of directors and proposes a transformation from passive diligence to systematic attention; Chapter 3 defines the boundary between supervision and intervention, and constructs a decentralized regulation strategy; Chapter 4: Distinguishing the Application of Business Judgment Rules and Clarifying bad faith as the Ultimate Red Line for Liability Invalidation.

2. Responsibility restructuring: from passive diligence to systematic attention

2.1. Power boundary of the board of directors: legal definition of system operation obligations

In the complex governance structure of modern multinational corporations, the parent company's board of directors faces severe challenges such as information asymmetry and blurred boundaries of responsibilities. The responsibilities of the board of directors should be precisely defined as a systemic operational duty, the key point of which is not to ensure that directors can personally intercept all violations, but to ensure that there is a scientific, sensitive, and timely feedback risk identification and reporting mechanism within the company. This definition not only reduces the burden on the board of directors, but also strengthens its ultimate responsibility for organizational governance capabilities.

2.1.1. The cyclical nature of duty of attention and the rationality of structural blind spots

The concept of duty of attention proposed by Bayless Manning aptly reveals the non-executive and cyclical characteristics of the supervisory function of the board of directors [4]. The board of directors is not like a continuously running closed-circuit television, but more like a periodically activated radar scanner.

This article argues that if the law forces directors to capture all the subtle signal changes at all business levels, it will not only lead to extremely serious information overload for directors, but also force them into the quagmire of micromanagement, ultimately causing them to lose the macro perspective they should have. So, the law needs to recognize the rationality of the existence of this structural blind spot. When fulfilling their duties, directors should focus on one aspect: whether the system has the ability to automatically issue an alarm and report the relevant situation to the decision-making level in a timely manner when the radar detects abnormal pulses. The recognition of such reasonable blind spots can be said to be an important foundation for maintaining the effective role of the external director system.

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2.1.2. Decision-makers and gatekeepers

When defining the responsibilities of directors, it is essential to clearly distinguish between their roles as business decision-makers and compliance gatekeepers. From a deeper legal perspective, the Business Judgment Rule focus on protecting those who actively engage in commercial ventures, and the core focus of their review is whether the procedures have reached a sufficient level of completeness; On the other hand, the Caremark framework focuses on addressing negative compliance failures, with the key core being the question of whether there are deficiencies in relevant systems. The significance of this binary path differentiation lies in its ability to effectively prevent courts from abusing BJR and granting inappropriate exemptions in the event of supervisory failure; It can also avoid making excessive demands on compliance responsibilities when business decisions ultimately fail. This distinction actually provides a kind of predictable certainty for directors to fulfill their duties, clearly indicating the evaluation standards and scales adopted by the law for their behavior in different scenarios [5].

2.2. Modern good faith view: from negative compliance to positive institutional construction

2.2.1. Institutionalization transformation of good faith obligations and objectification of bad faith

This article proposes that the modern meaning of the obligation of good faith has shifted from the traditional sense of not causing trouble to building a system. In the traditional sense, good faith only requires directors not to use illegal means to seek benefits, but Caremark and subsequent relevant precedents have identified systematic neglect of compliance systems as a form of bad faith that violates the duty of loyalty. This means that the construction of compliance systems has become an objective threshold for good faith. If the board of directors is aware that the company lacks basic compliance monitoring mechanisms in core areas but still fails to take action, then such willful blindness will no longer be protected by BJR [1]. The law is no longer just asking have people done anything wrong, but starting to ask to have people established a mechanism to prevent bad things from happening.

2.2.2. In-text citations

Under the continuous pressure of external laws such as the EU's Due Diligence Directive on Corporate Sustainability, the supervisory responsibilities of the parent company's directors are gradually undergoing a transformation towards publicization [6]. Its supervisory responsibilities have broken through the traditional logical framework that only focuses on asset preservation, and gradually begun to take on various functions related to public interests such as protecting human rights and the environment.

This responsibility presents a hardening trend, which means that the directors of the parent company are responsible to shareholders on one hand, and to stakeholders involved in the supply chain on the other hand. The return of this public attribute indicates that corporate social responsibility is undergoing a transformation, gradually shifting from more flexible moral constraints to more rigid legal obligations.

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2.3. Mission-critical risks: non-delegable responsibilities in the digital wave

2.3.1. The black box challenge of AI and data risk

In the context of digital transformation, the black box characteristic of AI algorithms has made traditional supervision methods almost ineffective [2]. When algorithms automatically engage in price discrimination or credit screening related operations, compliance risks are often hidden in complex data models.

This article holds the view that when the complexity of technology exceeds the capacity of traditional reporting mechanisms, the board of directors bears the ultimate responsibility for technical legitimacy review [4]. Although directors do not need to personally write code, it is important to ensure that the company has the auditing tools that can penetrate the black box.

2.3.2. Role of supervisors in hierarchical structures

The McDonald's case confirmed at the legal level that executives also bear the obligation of supervision, thus establishing a vertical compliance defense system. This rule further strengthens the role of the parent company as a supervisor of supervisors.

In such a hierarchical architecture, the board of directors is mainly responsible for carrying out top-level institutional design work, while executives are responsible for implementing signal interception operations at the execution level, and the business level needs to be responsible for real-time monitoring of various situations. The responsibility of the board of directors of the parent company is not to go deep into the front line, but to make every effort to ensure that the responsibility transmission mechanism between different levels will not be broken in any way.

3. Systematic construction of monitoring system and response to the red flag

3.1. Targeted monitoring by the parent company's board of directors

3.1.1. Vertical reporting path: direct mechanism for mission-critical risks

This article argues that not all risks faced by subsidiaries need to be reported to the parent company's board of directors. If all of them are reported, the decision-making level is easily trapped in a quagmire of many details. However, for risks that belong to the mission critical category, it is necessary to establish a reporting fast-track mechanism that can bypass the filtering process of the middle management.

Take the bribery case in Walmart Mexico as an example. If there was an independent reporting mechanism at that time, the bribery event might be effectively blocked when it was still in its infancy. The significance of this reporting mechanism lies in its successful breaking of the so-called structural silence within the company [3]. Whenever there are a significant risk and the corresponding threshold is reached, the signals related to it must be able to directly impact the board's desk, thus completely depriving the board of the possibility of using the statement of not knowing as a defense reason in the future.

3.1.2. From passive dependence to active risk scanning

The parent company must abandon the one size fits all supervision model. When allocating supervisory resources, there should be a proportional relationship with the risk level. For

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subsidiaries operating in high-risk compliance environments, the parent company's board of directors may require more frequent audit investigations.

This proactive approach to differentiated allocation can effectively counter accusations of systematic slackness and prove that the board's performance is based on informed decisions made after risk assessment, rather than blindly waiting in a passive state. And this initiative is precisely the key legal judgment standard that distinguishes between qualified directors and puppet directors.

3.2. Decentralized compliance divided by entity shielding

3.2.1. Distinguishing the boundary between procedural oversight and business intervention

The theory of entity shielding is the key to understanding the boundary between parent and subsidiary companies. Legitimate supervision must focus on controlling the compliance process and must not take over business decisions.

When the board of directors of the parent company directly intervenes in the specific contract signing or personnel appointment and removal arrangements of the subsidiary, its behavior will transform into the so-called exercise of operational control, which will greatly increase the risk of the parent company being identified as a shadow director [5]. So, the board of directors must exercise restraint in terms of procedures, that is, to supervise whether various systems are complete, and cannot intervene in the actual implementation of specific business processes. This restraint is not only in response to legal requirements, but also to maintain the risk firewall built between various legal entities within the group.

3.2.2. Decentralized compliance: institutional shield for preventing risk spread

The parent company should adopt the strategy of decentralized compliance, which means outputting the group's unified compliance values and policy outline, while delivering the specific implementation plan to the subsidiary company for autonomous completion.

In this mode, the subsidiary can maintain independence in management in terms of procedures, and in practice, it can also ensure that the compliance will be upheld by the parent company can penetrate different levels. Once a subsidiary violates regulations, given its independent decision-making power, the parent company can effectively demonstrate that it has fulfilled its obligations in terms of framework supervision.

3.3. Reaction window and procedural justice

3.3.1. Determination of elements triggered by responsibility

The determination of red flag signals should focus on the aspect of complete response chain. When determining whether there is a breach of contract by the board of directors, three factors need to be considered, namely whether the signal has sufficient attention, whether the channel is in a clear state, and whether the action is sincere [3].

If the red flag is raised, the board of directors will immediately shift from being a passive observer to an active crisis responder. Regardless of the form of strategic delay or formal handling, it will be considered a breach of good faith obligations. In the McDonald's case, it was precisely because executives systematically ignored sexual harassment complaints that they were ultimately found to have violated their duties.

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3.3.2. Rationality of remedial measures: rigorous procedures outweigh perfect results

The law does not mandate that the board of directors must eliminate all losses. The so-called reasonableness of remedial measures mainly lies in the completeness of the procedures, which depends on whether the investigation work has been immediately initiated, whether there are relevant records of deliberation, and whether corrective measures have been taken. This procedural justice is the fundamental condition for obtaining BJR protection. If the board of directors can confirm that its response measures are based on thorough investigation and honest judgment, then even if it ultimately fails to prevent the occurrence of fines, individual directors should still be exempted. The objects protected by law are those who have tried their best, have a genuine attitude, and may encounter failures.

4. BJR's procedural protection and failure red line

4.1. BJR protects diligence in the process

4.1.1. Reasonability review and evidence chain construction

The Business Judgment Rule should be seen as a procedural safe harbor. If the board of directors can confirm that its decisions are based on reviewing relevant reports, questioning management, and giving reasonable trust to expert opinions, then the court should respect its business judgment [7].

The board should provide a complete chain of evidence, such as meeting minutes, external consulting reports, and internal risk assessment plans. There should be a clear and explicit boundary between law and business. If the directors have already fulfilled their diligent and responsible process, then the court should not question their decisions at that time with a smart after the fact attitude.

4.1.2. Repair of procedural defects and the defense function of compliance systems

If there is a failure in compliance, an operational supervision system can still serve as a defense. The board of directors can propose that it is precisely because of the existence of a supervisory system that violations can be detected and stopped, thereby reducing losses.

This logic defines compliance failure as a necessary process for the system to discover and correct it. If the foundation on which the Procedure is based is established, then the failure of compliance should not be naturally equated with director negligence. This shift in perspective can to some extent alleviate the accountability anxiety of directors [8], prompting the board to focus on improving the system rather than reducing access to relevant information for defensive purposes.

4.2. The red line of failure: bad faith as the ultimate threshold

4.2.1. Criteria for systemic neglect and willful blindness

Bad faith presents a state of governance paralysis in supervised scenarios: if the board of directors clearly sees that the core compliance red line is constantly being trampled upon but fails to take action, then this prolonged silence constitutes what is legally known as willful blindness.

The purpose of setting the failure criteria on bad faith rather than general negligence is to prevent the proliferation of the right to pursue responsibility. Empirical research has shown that the actual risk of external directors facing out-of-pocket compensation is extremely low, and the vast majority

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of losses are covered by company compensation or insurance mechanisms, providing necessary safety space for directors to fulfill their supervisory responsibilities [9]. Setting a higher threshold is a rational choice between strict governance and talent attraction. Only when the behavior presents a situation of complete abandonment of duty, will the law deprive BJR of the shield it provides.

4.2.2. Entity shielding and defense logic for limited liability

When the threshold for BJR is set relatively low, the parent company is prone to excessive supervision, which can lead to a sharp increase in the cost of information transmission and may even induce moral hazard issues in subsidiaries. Persisting in treating bad faith as a failure red line ultimately means using legal means to maintain the appropriate distance between parent and subsidiary companies.

With such a sense of distance, it is possible to control risks while also preserving the dividends inherent in limited liability. Limited liability will encourage people to take risks, and correspondingly, reasonable supervision standards are precisely the solid legal barrier of this system [10].

5. Conclusion

This article takes the supervisory responsibilities of the parent company's directors as the research object, and systematically explores how the duty of oversight should be defined, fulfilled, and defended in the complex governance structure of multinational enterprise groups. This article proposes the following core points. Firstly, the supervisory responsibility of the parent company's board of directors should not be generalized as a omniscient and omnipotent responsibility for every minor violation of the subsidiary, but should be precisely defined as a systemic operational duty. The core of this obligation is to ensure that there is a scientific, sensitive, and timely risk identification and reporting mechanism within the company, rather than guaranteeing that directors can personally intercept all violations. Secondly, the good faith of directors has evolved from the traditional no trouble approach to a proactive institutional construction. The construction of a compliance system has become an objective threshold for good faith. If the board of directors knows that the company lacks basic compliance monitoring mechanisms in core areas but fails to act, this willful blindness will no longer be protected by the Business Judgment Rule. Thirdly, for mission-critical risks, the board of directors has a non-delegable oversight obligation. In the digital age, the black box nature of AI algorithms requires the board of directors to bear the ultimate responsibility of technical legitimacy review to ensure that the company has audit tools that can penetrate the black box.

This article emphasizes that the protected object of the Business Judgment Rule is not the correct result, but the reasonable decision-making process. As long as the board of directors can prove that its decisions are based on a review of reports, questioning of management, and reasonable reliance on expert opinions, the court should respect its business judgment. Positioning the failure criteria as bad faith rather than general negligence is a rational choice between the strictness of governance and the attractiveness of talent.

The theoretical contribution of this article lies in proposing the concept of system operation duty and reconstructing the legal basis for the supervisory responsibilities of the parent company's directors; Building a decentralized compliance strategy to balance the tension between supervision and independence; Clarify bad faith as the ultimate red line for BJR failure, providing actionable judgment standards for judicial practice. Future research can further explore the evolution of the

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dynamic threshold of duty of care under technological empowerment, as well as the localization adjustment issues of emerging market countries when drawing on the experience of Delaware.

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